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SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

US efforts to build up Japanese trade are having favorable results in Southeast Asian countries (page 2). However, during June, textile production in Japan largely imposing a serious deterrent to the efforts to increase foreign trade (page 4). Modification rather than revocation of the SCAP suggested labor restrictions appears likely (page 4).

Failure of the Republic of Korea to implement a fall rice collection program will imperil the effectiveness of US economic aid and threaten the long term stability of the Republic (page 5). The announced withdrawal of Soviet occupation from North Korea can be of great propaganda significance in the forthcoming meeting of the UNGA (page 5).

Military preparations for the anticipated Communist offensive were high lighted this week by "reconnaissance in force" of the government defenses along the Peiping-Mukden railway (page 7). The Government's position in Manchuria continues to worsen with the Mukden food problem growing more critical (page 7). Red disruption of the Chihhsien-Tangshan rail line poses a serious coal problem for China industry (page 8). The economic status of the Government continues fairly stable, but is believed to be only temporary (page 9).

The assassination in Burma of Tin Tut may foreshadow further difficulties (page 10).

Attrition of French troop strength in Indochina has greatly reduced French capabilities (page 11).

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

Chinese ex-Premier Chang Chun completes visit to Japan

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In his first public utterance after returning from Japan, Chang Chun stated that: (1) for Japan alone to be the "workshop" of the Orient is unacceptable since it needs cooperation from its neighbors; (2) Japan's state of democratization is unsatisfactory and, even though Japan has complied with SCAP directives it "needs a new attitude;" (3) China has presented SCAP with a list of several hundred war criminals wanted for trial; (4) China favors an early peace. These remarks give the impression of being tailored to fit the preponderant Chinese public opinion regarding Japan.

Japanese press reaction to Chang's visit, while recalling the history of Japanese aggression in China and the latter's present attitude, was one of naively hoping that Chang would somehow effect a miraculous reconciliation between the two countries.

Chang's visit may have explored the possibility of an early peace treaty but it is unlikely that China could seriously expect to play the "go-between" for adjusting the divergent views of the US-USSR on the subject. It is more likely that the trip was motivated by (a) a desire to discover a modus operandi, particularly economic, between China and Japan pending a peace treaty, (b) and possibly to ascertain MacArthur's attitude towards additional aid for China particularly in the light of the coming US election.

Jap trade prospects favorable in Siam and FIC but weaker in Philippines

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US efforts to revive Japanese foreign trade with other Far Eastern countries continue to bear fruit. Japan and Siam are said to have concluded a \$68,000,000 trade agreement whereby Japan will export to Siam rolling stock and steel plus some cotton textiles and consumer goods in return for rice and sizeable quantities of salt, coconut oil, tin ore, copra cake, rubber and other raw materials for industrial purposes. This is the first comprehensive bilateral trade agreement between Japan and Siam since the war.

US Consul Saigon reports an increase in actual or anticipated trade between Japan and FIC. Indications of this are the sale by FIC of 6,000 tons of corn and 26,600 metric tons of anthracite coal to Japan; according to reports, Japan will purchase 200,000 additional tons of FIC anthracite during 1949. In return, Japan is shipping such items as silk, small

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GENERAL (continued)

electric motors, parts for cranes and soft coal.

On the other hand, US Embassy Manila advises that the Philippine Government has adopted a formal policy of limited and strictly controlled trade between the Philippines and Japan until such time as a peace treaty is signed. It states that the Philippine Government had been cautiously building up trade with Japan - largely Philippine copra, hemp, coal and some manganese ore in exchange for Japanese galvanized iron sheets, cement, plate glass and other reconstruction material - until certain unfortunate remarks by General Nee, then US Army Chief of Civil Affairs, crystallized Philippine public opinion against such resumption of trade. The Embassy believes that the Philippines still wishes to become the leading industrial nation in the Far East but will continue to trade with Japan so long as a balance of trade favorable to the Philippines continues. However, Philippine public opinion will limit the extent of such trade.

Japanese trade progress in Siam and the FIC fit in with the pattern of a resumption of Japanese trade in the Far East. The best post-war improvement has been made in Southeast Asian countries. However, the favorable response in Southeast Asia to Japanese trade can have only a short-term beneficial effect especially in view of the increasingly unstable conditions within that area. From a long-run point of view, Japan's primary chances for economic revival lie in the reopening of channels to North China, Manchuria, and Korea, areas now rendered inaccessible or unstable because of communist action.

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JAPAN

Japanese production in June continues rising curve. Japanese production in June totalled more than fifty percent of the 1930-1934 level for the second month in succession, reflecting chiefly increased coal output. SCAP officials advised, however, that textile production lagged and constituted "a major depressing element." Prices rose sharply but this was a result of a shortage of staple foods on the official market and of the substitution of sugar for cereals in ration and not a drastic change from the preceding period of relative price stability. Wages continued to rise with rising prices. Despite continued deficit spending and increased currency issue, some improvement in government finance was noted. Bottle-necks in foreign trade rather than inflation are said by SCAP officials to constitute the major obstacle to Japanese economic recovery.

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Although the slowly rising Japanese production index indicates progress of Japan's industrial economy toward the 1930-1934 level, the depressed textile production is a major disturbing element because primary efforts towards Japanese economic rehabilitation have been directed toward the development of textile trade. However, the rate of recovery of textile production since the end of the war has compared favorably with that of other manufacturing industries in Japan. Improvement may be expected as raw cotton imports increase as a result of recent US measures. Nonetheless, although Japan is moving to overcome its raw material shortage problems, the over-all problem of finding markets will constitute a major obstacle. (See general article - Page 2.)

Modification rather than revocation of SCAP suggested labor restrictions likely. The expected attack in the FEC on the July 22 SCAP letter suggesting limitation of the trade union rights of Japanese government employees (see ORE Weekly 30 July 1948) developed at the 16 September meeting. Soviet Ambassador Panyushkin, challenged General MacArthur's authority for issuing this letter and the defense thereof offered by SCAP's deputy Sebald in the Allied Council for Japan (ACJ). The Soviet Ambassador proposed an FEC directive requesting that SCAP revoke his "suggestions" and the Japanese government ordinance issued to implement them.

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In the face of a US veto in the FEC the Soviet representation is unlikely to compel retraction of occupation policy. Soviet ends are being served, nevertheless, by the embarrassment FEC consideration of the labor problem gives to powers friendly to the US. These powers, notably the UK and Australia, follow at home principles regarding government employee rights which are not consistent with those offered in General MacArthur's letter. Australian representative Makin read a carefully worded statement indicating his government's continuing interest in the issues involved and reaffirmed Australia's desire as expressed in the ACJ to make a constructive contribu-

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JAPAN (Cont.)

tion toward settlement thereof on the basis of the experience of British Commonwealth countries in labor relations.

The Secretary of the Army has publicly denied the existence of any conflict between the SCAP letter and basic occupation policy. Nevertheless, the US Government has indicated that it is reviewing the interim ordinance and will scrutinize draft legislation for conformance with occupation objectives. Modification of the restrictions appears likely when the Diet convenes to replace the Cabinet order with permanent legislation. The probable manner in which the changes may be made, was indicated in Sebald's statement to the Allied Council that the Japanese Diet "will consider and perhaps adopt" concepts of "systems relating to public employment quite as efficient and democratic as that in the US."

KOREA

Failure of the Republic of Korea to implement a fall rice collection program will imperil the effectiveness of US economic aid and threaten the long-term stability of the Republic. The projected US program of economic aid is based on the promise of effective internal controls on the Korean economy. With South Korea still a food deficit area and with rice the most vital item in the economy, continuation of the successful rice collection and rationing program instituted during the US occupation is essential. Failure to carry out such a program this fall will result in large-scale smuggling of rice to Japan and China, hoarding and excessive profiteering, and acute food shortages in the cities, culminating next spring in serious popular unrest and a grave internal crisis for the government which will also be menaced by externally-directed sabotage and aggression. Under such conditions, US aid will be ineffective in checking mounting inflation and in rehabilitating the South Korean economy.

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The failure to implement a rice collection program at an early date is due, in part, to the government's major concern with other pressing domestic and external political problems. More important is the lack of firm leadership in the Cabinet. Although influential landlords, the peasants, and many Assemblymen oppose rice collections, the opposition is not so strong that determined action by the President and Cabinet could not obtain approval for an effective program.

The anticipated Soviet announcement of the withdrawal of occupation forces from North Korea (see Intelligence Highlights No. 17) is solely of propaganda significance. The move has long been in preparation as a means of bolstering the Soviet position by putting the US on the defensive in the forthcoming UNGA discussions of the Korean problem. The Soviet High Command

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KOREA (Cont.)

has been stripping its forces in North Korea since May 1948 with the result that they now have the capability of executing a complete withdrawal within 30 days. Since the Kremlin has not committed itself to withdrawal before 1 January 1949, direct Soviet military control of North Korea need not be relinquished during the critical period of the UNGA discussions. Moreover, the institutional structure of the North Korean puppet regime assures the maintenance of adequate Soviet control following any future withdrawal of Soviet forces.

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CHINA

Preparation for a Communist general offensive is evident. The current Communist military activity in the Tientsin-Chinhkien corridor appears to be a "reconnaissance in force" with the Communists probing weak points in Nationalist defenses. Incidentally the raids have already inflicted serious damage to the Peiping-Mukden Railroad. Action thus far has centered in areas to the north and south of Chinhkien and on both sides of Chengli where the vague line of demarcation separating the military commands of FU Tee-yi and FAN Han-chieh invites Communist attacks. Meanwhile, Communists have stepped up activity on the outskirts of Tsinan in an effort to further tighten the ring around the strategic Shantung capital. The main body of Red General CHEN Yi's forces is reported halfway between the Government strongholds of Neuchow and Tsinan, thereby placing the Communists in a favorable position to move on either city.

"B"

Present food stockpiles in isolated Mukden are inadequate. A recent report estimates the current stockpiles of food in Mukden sufficient to feed only the military and industrial workers for approximately one week. This estimate does not include the remainder of the civilian population. Although this appears a trifle extreme, the food situation in Mukden is very serious and in all likelihood will become critical. Contributing to this condition is the inadequacy of the airlift from intramural China and the fraudulent grain dealings of WEI Li-huang's subordinate commanders. (WEI, however, stands to be the scapegoat because he steadfastly refuses to ameliorate the situation by opening an overland supply route to the port of Yinkou). In addition to the shortcomings of the airlift and the cupidity of unit commanders, the prospect of a poor harvest probably will make it impossible to procure adequate foodstocks locally. The conjunctive effects of these factors produce the very real danger that Mukden will be reduced in time to the present status of Changchun where several hundreds are starving to death each day and large numbers are eating tree bark and grass roots.

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CHIANG Kai-shek's speech urging an all-out austerity program follows the pattern set by the anti-corruption campaign being conducted in Shanghai by his eldest son, CHIANG Ching-kuo. As Deputy Economic Supervisor in Shanghai, young CHIANG is enforcing the new economic reforms by stern measures and has advocated a plan for a socialist economy. The austerity program of the Generalissimo, combined with the plans for political and social reforms now being pushed in Nanking, would extend the Shanghai measures throughout Nationalist China. The Generalissimo's speech, however, was couched in general terms and while there appears to be a great deal of serious talk in Government circles concerning reform, constructive measures have yet to be undertaken. In the past the Government has made vague gestures toward reform but has done nothing. To implement the reforms now envisaged would mean attacking vested interests which are the Generalissimo's principal means of

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support and, therefore, would indicate a complete about-face of which CHIANG previously has been incapable. The outcome of any new reforms will depend entirely upon the measures taken to enforce them.

Peace and neutrality sentiment grows in Nationalist China. Recent reports of secret meetings between the Soviet Ambassador and the Chinese Foreign Minister coupled with the information that US officials have been advised of the existence of a clique which wants to insure Chinese neutrality in the event of a US-USSR war via Soviet appeasement, indicates a growing sentiment in Nationalist circles for neutrality. The USSR can be expected to play on this growing sentiment through covert if not overt means. Although the peace and neutrality sentiment in Nationalist circles appears to be steadily increasing, CHIANG Kai-shek is hopeful of continuing and increasing US aid, and probably will be capable of withstanding internal pressures for peace until confronted with major military reverses or new economic and political crises. When such a situation develops the USSR may offer its good offices as mediator in the Chinese civil conflict.

"B"

A more liberal Nationalist policy seen in Sinkiang. Gen. CHANG Chih-chung, Chief of the Northwest Headquarters, will have a better chance of implementing his program of reform in Sinkiang now that Gen. SUNG Hsi-lien has been removed from the post of Sinkiang Garrison Commander. SUNG was transferred in July and replaced by Gen. TAO Shih-yao, concurrently Deputy Chief of Northwest Headquarters and a follower of CHANG Chih-chung. SUNG who advocated a policy of rule by force, had been a major obstacle to the implementation of CHANG's conciliatory policy toward the non-Chinese natives of Sinkiang. Evidence of the change in Tihwa's policy comes with the reported resignation of the Tihwa Zone Commissioner in protest against "the weak-kneed policy since Gen. SUNG left," and charging Gen. TAO with failure to back security measures.

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Rail interruption imperils Nationalist coal supply. The coal supply of principal Nationalist cities is threatened by Communist disruption of rail traffic between Tangshan and Chinwangtao. The Kailan mines, located near Tangshan, supply coal to an estimated 70% of Nationalist China's industrial installations. Coal destined for Shanghai, Tsingtao, Nanking and other important Nationalist cities to the south must be transported by rail from Tangshan to the port of Chinwangtao, thence shipped by water to consumption centers. More than one-third of the coal output of the Kailan mines is shipped via this route. Since most of China's industry is concentrated in the Shanghai-Nanking area the serious consequences of any prolonged interruption in rail transportation from Tangshan to Chinwangtao cannot be over-emphasized.

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Rigid economic enforcement holds Shanghai-Nanking markets steady. Foreign exchange and commodity markets in the Shanghai-Nanking area continued stable during the past week, due almost entirely to the rigid economic enforcement measures of Gen. CHIANG Ching-kuo, although conditions were not favorable elsewhere. Peiping reports a definite black market of GY47.0 to US \$1, nearly twice the official rate, while food prices increased 30 to 150%. Prices also rose in Mukden and Canton. A competent foreign advisor to the Central Bank has told the US Consul General in Shanghai that (a) the currency program is going very badly, (b) no serious effort is being made except in Shanghai and Nanking to carry out essential Government reforms, (c) in face of mounting pressure the Government is continuing its policy of deficit financing, (d) production and commerce are coming to a standstill, (e) present enforcement action probably cannot contain inflationary forces longer than another month, and (f) the inevitable break will reflect accumulative pressure causing a financial crisis worse than that of the July-August period. "B"

Gold yuan note issue. The Central Bank reports that the outstanding note issue on 17 September was over GY 800 million. This is equivalent to CN \$2,400 trillion compared with less than CN \$700 trillion in circulation on 19 August. "C"

ECA approves US \$70 million for over-all China projects. ECA has provisionally approved allocation of US \$35 million for replacement projects and US \$35 million for reconstruction purposes. Funds already earmarked, including those previously announced, are (a) railroads: Canton-Hankow \$5,000,000; Chekiang-Kiangsi \$2,500,000; Peiping-Tientsin \$1,500,000; Taiwan Line \$1,500,000; and (b) power systems: at Taiyuan, Mukden, Tsingtao, Peiping, Tientsin, Chungking, Hankow, Taiwan, and others, totaling US \$8,750,000. "C"

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BURMA

Tin Tut's assassination may foreshadow further difficulties. The assassination on 19 September of U Tin Tut, Inspector-General of the Burma Auxiliary Force and former Foreign Minister, while not expected to alter the existing situation in Burma, does, however, accentuate the general insecurity prevailing throughout the country as well as the inability of the Burmese Government to maintain law and order even in Rangoon. There are so many possibilities as to who is responsible for his death that speculation about who is guilty at this time would be purely academic. Moreover, assassination of more public figures in the near future is a distinct possibility in view of the numerous political factions which have developed. Although for sometime no Burmese politician's life will be secure, it is possible that it will be men like Tin Tut (who was considered relatively conservative by present Burmese standards because of his close connection with the British in the past) will be the main objective of future liquidations. Their loss would deprive any government in Burma of the services of the few remaining Burmese qualified to hold responsible governmental positions.

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Meanwhile, tension between Karens and Burmans, which officials in Rangoon appear to be disregarding, is increasing. The Karen National Union (KNU) was not given representation in the recently formed cabinet, the composition of which left little doubt that the Socialists intend to continue their attempts to run the Government. The Government has undertaken to raise police levies, ostensibly to fight communists, but this operation has taken on an increasingly political aspect despite the objections of such non-party men as Tin Tut, Supreme Commander Smith Dun and Bo Let Ya, formerly Deputy Prime Minister. Available information indicates that only Burmans are being recruited and it is believed that these levies will amount to a private army of the Socialist Party to be used to maintain its position. The Karens are naturally resentful of this discrimination and are apprehensive as to the manner in which these inexperienced and untutored levies will be used. Furthermore, there is still some agitation to disarm the Karens which, if attempted, is certain to cause a great deal of bloodshed. Unless satisfactory agreement is reached between Karens and Burmans in the near future, increasingly serious incidents may occur. Containment of communal warfare would then be impossible and any pretenses of an overall Burmese Government would be a farce. Although Thakin Nu appears to be aware of the seriousness of the situation and has been consistently conciliatory towards Karens and their aspirations, he has been unwilling or unable to take appropriate action, probably as a result of objections from his Socialist colleagues.

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INDOCHINA

Attrition of French military establishment serious. It has been "B"
reliably reported that of the 108,000 troops available to the French in
Indochina, 37,000 are indigenous troops with the ratio rising at the
rate of about 1,000 per month. This loss of fighting power and the
deterioration of equipment has resulted from well-planned and executed Viet
Minh attacks and has led to extremely low French morale. In addition,
French officers are reported to have little confidence in either their
military or political leadership. Although French troop reinforcements
are expected within a month, they include only enough to cope partially
with the anticipated increase in Viet Minh guerrilla activity. Further-
more, French officers believe that a solution must be reached within
six months as transportation will then be virtually exhausted.

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